

**TITLE: CIB 91-18 OFPP Policy Letter 91-2 -- Service Contracting**

Agency for International Development  
Washington, D.C.

March 14, 1991

MEMORANDUM

TO: Distribution List FAC

FROM: DAA/MS, John F. Owens, Procurement Executive

SUBJECT: OFPP Policy Letter 91-2 -- Service Contracting

**CONTRACT INFORMATION BULLETIN 91-18**

OFPP Policy Letter 91-2 establishes government-wide policies for acquisition of services. A copy of this Policy Letter and an Office of Federal Procurement Policy background memo on it is attached for your guidance.

Please note particularly the preference for performance based statements of work (based on what is needed, rather than how it is to be accomplished), and the requirement to develop formal, measurable performance standards and surveillance plans for evaluation of contractor performance.

You should use your best efforts to insure that scopes of work under new service contracts are performance based, and that formal quality assurance standards are included in the contract. To the extent the requirements of Policy Letter 91-2 cannot be applied, the memorandum of negotiation should provide specific explanation and justification.

Attachments: a/s

EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

April 9, 1991

Office of Federal  
Procurement Policy

POLICY LETTER 91-2

TO THE HEADS OF EXECUTIVE AGENCIES AND DEPARTMENTS

SUBJECT: Service Contracting

1. Purpose. This Policy Letter establishes policy for the Government's acquisition of services by contract. It emphasizes the use of performance requirements and quality standards in defining contract requirements, source selection, and quality-assurance. This approach provides the means to ensure that the appropriate performance quality level is achieved, and that payment is made only for services which meet contract standards.

2. Authority. This Policy Letter is issued pursuant to section 6(a) of the Office of Federal Procurement Policy (OFPP) Act, as amended, codified at 41 U.S.C. section 405.

3. Definitions.

a. "Performance-based contracting" means structuring all aspects of an acquisition around the purpose of the work to be performed as opposed to either the manner by which the work is to be performed or broad and imprecise statements of work.

b. "Services" are defined as the performance of identifiable tasks rather than the delivery of an end item of supply. "Services" also include tasks that are delivered under a contract where the primary purpose of the contract is to provide supplies. For the purpose of this Policy Letter, requirements for architect-engineer services acquired in accordance with the Brooks Act (P.L. 92-582, as amended) and for construction are excluded.

4. Background. Each year the Government contracts for a significant amount of services. Such services range from the routine maintenance of facilities or equipment to highly sophisticated technical and management assistance such as the design, development and furnishing of systems, or expert assistance for management and program activities. Attempts to apply contracting methods which are inappropriate to the services being acquired have often resulted in unsatisfactory performance and contract administration problems, as reflected in several internal agency investigations and evaluations, General Accounting Office Reports, and OFPP studies. These reports criticized unnecessarily vague statements of work, insufficient use of firmer pricing arrangements, the lack of quantifiable performance standards, and the inadequacy of quality assurance surveillance. In addition, there is concern that the Government underemphasizes quality vs. price

in the acquisition of services. The use of performance-based service contracting methods enhances the Government's ability to acquire services of the requisite quality and to ensure adequate contractor performance.

5. Policy. It is the policy of the Federal Government that (1) agencies use performance-based contracting methods to the maximum extent practicable when acquiring services, and (2) agencies carefully select acquisition and contract administration strategies, methods, and techniques that best accommodate the requirements. In addition, agencies shall justify the use of other than performance-based contracting methods when acquiring services, and document affected contract files. Performance-based contracting methods consist of the following:

a. Statement of work. When preparing statements of work, agencies shall, to the maximum extent practicable, describe the work in terms of "what" is to be the required output rather than "how" the work is to be accomplished. To assist in refining statements of work, consideration shall be given to issuing draft solicitations.

b. Quality assurance. Agencies shall, to the maximum extent practicable, assign contractors full responsibility for quality performance. Agencies shall develop formal, measurable (i.e., in terms of quality, timeliness, quantity, etc.) performance standards and surveillance plans to facilitate the assessment of contractor performance and the use of performance incentives and deduction schedules. Agencies shall, to the maximum extent practicable, avoid relying on cumbersome and intrusive process-oriented inspection and oversight programs to assess contractor performance.

c. Selection procedures. Agencies shall use competitive negotiations for acquisitions where the quality of performance over and above the minimum acceptable level will enhance agency mission accomplishment and be worth the corresponding increase in cost. This approach will apply to most technical and professional services. In such instances, contracting activities shall give careful consideration to developing evaluation and selection procedures that utilize quality-related factors such as: technical capability; management capability; cost realism; and past performance. These factors shall receive increased emphasis to the extent requirements are more complex and less clearly defined. The desired relative importance among these factors and between these factors and price shall be determined, and they shall be applied as stated in the solicitations. To ensure application of cost realism, cost proposals shall be reviewed to assess offerors' understanding of the requirements and consistency with their technical proposals. Special attention shall be directed to limiting opportunities for technical leveling and technical transfusion. Technical leveling and technical transfusion discourage offerors from proposing innovative methods of performance and often result from repeated discussions and the submission of revised offers based on these discussions.

Opportunities for discussions and revisions of offers shall be limited to the extent practicable. Sealed bidding shall be used when the goal of the acquisition is to achieve the desired service at the lowest price with minimum stated acceptable quality.

d. Contract type. Contract types most likely to motivate contractors to perform at optimal levels shall be chosen. Fixed price contracts are appropriate for services that can be objectively defined and for which risk of performance is manageable. In most instances, services that are routine, frequently acquired, and require no more than a minimal acceptable level of performance fall into this category. For such acquisitions, performance-based statements of work and measurable performance standards and surveillance plans shall be developed and fixed price contracts shall be preferred over cost reimbursement contracts. Cost reimbursement contracts are appropriate for services that can only be defined in general terms and for which the risk of performance is not reasonably manageable. Complex or unique services for which quality of performance is paramount frequently fall into this category. Furthermore, to the maximum extent practicable, contracts shall include incentive provisions to ensure that contractors are rewarded for good performance and quality assurance deduction schedules to discourage unsatisfactory performance. These provisions shall be based on measurement against predetermined performance standards and surveillance plans.

e. Repetitive requirements. When acquiring services which previously have been provided by contract, agencies shall rely on the experience gained from the prior contract to incorporate performance-based acquisition methods. For such follow-on requirements, statements of work shall further describe the services in terms of "what" is to be performed, and performance standards and surveillance plans shall be more definitive than those for the prior acquisition. Where appropriate, conversion from a cost reimbursement to fixed price arrangement shall be accomplished and, whenever possible, incentive provisions and quality assurance deduction schedules shall be introduced.

f. Multiyear contracting. Agencies with statutory multiyear authority shall consider the use of such authority when acquiring services. The use of such authority will increase competition by offering a more stable, long-term contracting environment. It will also encourage offerors to invest in the development and implementation of innovative and efficient methods of performance by ensuring recoument of these investments.

## 6. Responsibilities.

a. Federal Acquisition Regulatory Council. The Federal Acquisition Regulatory Council shall ensure that Government-wide regulations to conform to the policies established herein are promulgated in the first Federal Acquisition Circular issued 120 days after the effective date of this Policy Letter. These regulations shall include a framework for individually tailoring the source selection method, type of contract, and contract administration techniques to fit the requirement, and for agencies to document the reason(s) for not using performance based contracting methods as prescribed by that framework.

b. Heads of Agencies. Heads of agencies are encouraged to implement the policies established herein and initiate any necessary staff training upon the effective date of this Policy Letter.

7. Information Contact. For information regarding this Policy Letter contact Stanley Kaufman, Deputy Associate Administrator, Office of Federal Procurement Policy, 725 17th Street, NW, Washington, DC 20503, telephone (202) 395-6803.

8. Effective Date. This Policy Letter is effective 30 days after the date of issuance.

Allan V. Burman  
Administrator

OFFICE OF MANAGEMENT AND BUDGET  
Office of Federal Procurement Policy

Policy Letter on Service Contracting

AGENCY: Executive Office of the President, Office of Management and Budget, Office of Federal Procurement Policy.

ACTION: The Office of Federal Procurement Policy (OFPP) is issuing a Policy Letter dealing with Service Contracting.

SUMMARY: This OFPP Policy Letter establishes policy for the Government's acquisition of services by contract. It promotes quality, economy and innovative through the use of performance-based contracting methods.

Each year the Government contracts for a significant amount of services. During FY 1990, for example, service contracting by Government agencies amounted to over \$10 billion. However, the Government may not be obtaining sufficient performance for the money expended, due to the use of inappropriate contracting methods. Problems commonly found with service contracts result from:

- o Unnecessarily vague statements of work, which increases costs or make it difficult to control costs;
- o Insufficient use of fixed price and incentive fee pricing arrangements for repetitive requirements, resulting in increased costs and inadequate incentive to improve performance, and
- o Nonexistent or inadequate contract administration plans, which lead to unauthorized commitments by the Government and delayed contract completion.

Performance-based service contracting methods prescribed by the Policy Letter should improve the Government's ability to acquire services of the requisite quality and to assess contractor performance and price. Such methods focus on:

- o Defining statements of work to describe "what" work should be performed rather than "how" it should be performed. This approach encourages bidders/offerors to develop innovative, efficient and cost effective means for performing the required level of service. It concentrates on achieving results rather than on documenting a contractor's activities. "How to" statements of work can result in contractors complying with contractual requirements, but failing to accomplish the desired end results in an efficient, economical manner.
- o Developing formal measurement criteria to assess actual performance against predetermined performance standards and assigning contractors full responsibility for quality performance. This approach facilitates the use of fixed price contracts, with the concomitant benefit of reducing the Government's risk and contract administration burden. Nonexistent or inadequate quality assurance plans make it impossible for the Government to accurately assess contractor performance and provide effective incentives.

- o Using evaluation and selection procedures which emphasize attracting the most competent contractors in addition to obtaining the lowest price. Such procedures should provide offerors maximum flexibility in proposing efficient and innovative methods of performance. Inattention to quality-related factors leads to the selection of contractors with marginal capability who submit the lowest prices but then perform at unsatisfactory levels.

- o Incorporating incentive provisions and quality assurance deduction schedules into contracts to motivate contractors to perform at maximum efficiency. Lack of such terms discourage the most competent entities from competing, competitors from dedicating their best personnel, and awardees from putting forth their best efforts.

In view of the diversity of services acquired by the Government, no single acquisition strategy or set of applied. The proper acquisition strategy depends on the level of expertise needed, the agency's ability to state its requirements objectively, and the contractor's ability to manage risks. In implementing performance-based service contracting practices, the prevailing strategy for many acquisitions of "lowest price and minimal acceptable quality" will be replaced by an approach that emphasizes quality of performance along with price.

This Policy Letter is published pursuant to the authority of Section 6. (a) of the Office of Federal Procurement Policy Act, as amended (41 U.S.C. 405), which authorizes the Administrator, OFPP, to prescribe Government-wide procurement policies.

SUPPLEMENTARY INFORMATION: A proposed Policy Letter and request for comments was published in the September 14, 1990 Federal Register (55 FR 37991). OFPP received thirty-seven responses to the Federal Register notice. Of the responses, fourteen were from Government agencies and twenty-three were from the private sector. Significant comments received and OFPP responses to the comments are below:

1. Duplication of existing regulations. Several agencies commented that many of the principles addressed in the Policy Letter are already contained in various Parts of the Federal Acquisition Regulation (FAR), and are, therefore, redundant. Examples cited were: preference for functional specifications (Part 10); selection of evaluation factors (Part 15); selection of contract type (Part 16), use of multiyear contracting (Part 17); and promotion of quality assurance surveillance (Part 46); OFPP recognizes that many of the principles contained in the Policy Letter are not new. However, the FAR does not provide an overreaching approach to contracting for services, and several of the aforementioned FAR provisions were drafted with a primary focus on supply contracts. The lack of an overarching approach is a primary reason behind the performance and cost control problems described in Paragraph 4. Background of the Policy Letter. The Policy Letter intentions addresses these principles within the overarching goal of structuring service contracting around the purpose of the work to be performed.

2. Emphasis on quality in service contracting. A few private sector commenters remarked that the Policy Letter does not sufficiently prescribe an overall requirement to emphasize quality in the

acquisition of services. It is OFPP's intent to emphasize the importance of quality in service contracting. Accordingly, we articulated this emphasis in the proposed draft Policy Letter at: Paragraph 1. Purpose; Paragraph 4. Background; and Subparagraphs 5(b) Quality assurance, 5(c) Selection procedures, and 5(d) Contract type. OFPP also believes that contracts for services should set forth the expected levels of performance quality. We placed this requirement under Subparagraph 5(b) Quality Assurance. Nevertheless, in view of the comments, the emphasis on quality in the Policy Letter has been increased by providing modified and/or added language to Paragraphs 1 and 4, and Subparagraph 5(c).

3. Services performed under supply contracts. A few agencies commented that services performed under supply contracts are often a relatively minor part of the acquisitions in terms of cost or level of effort, and, therefore, should not be subject to the requirements of the Policy Letter. OFPP does not consider predominance of the requirement to be an adequate justification for exempting these services from coverage. The failure to adequately define services under supply contracts, select the contractors who can best perform them, and assure expected performance levels can lead to the same problems as in pure service contracts and impair the overall acquisitions.

4. Definition of architect-engineer services. One private sector commenter stated that the Policy Letter's exclusion of architect-engineer services from the definition of "services" was ambiguous, and that the exclusion should be clarified by referring specifically to the Brooks Act (P.L. 92-582, as amended) regarding such services. OFPP's intent in excluding architect-engineer services from coverage by the draft Policy Letter was to avoid inconsistency with the requirements of the Brooks Act. Therefore, we have revised the definition accordingly.

5. Complex and technical services. One private sector commenter recommended that Paragraph 4. Background provide examples of complex and technical services to provide a baseline against which more routine services can be compared to determine how to best implement the tenets of the Policy Letter. OFPP agrees with this comment and has revised Paragraph 4 of the Policy Letter accordingly.

6. Performance-based contracting methods. Two commenters concluded that OFPP intended to define "performance-based contracting methods" as the subjects addressed in Subparagraphs 5(a)-(f) of the Policy Letter, but stated that this intent was not sufficiently clear. OFPP believes that the term is adequately defined by Subparagraphs 5(a)-(f). Nevertheless, Paragraph 5. Policy has been amended to clearly link the term to the Subparagraphs.

7. Justifications for the use of other than performance-based contracting methods. Many agencies commented that the requirement to justify and document the use of other than performance-based contracting methods is burdensome and unnecessary. OFPP is sensitive to the many time-consuming paperwork burdens imposed on the Federal acquisition process. Nevertheless, the significance of this Policy Letter to the Federal acquisition process and the magnitude of problems it is aimed at correcting require an enforcement mechanism to ensure

compliance. During the development of the Policy Letter many agencies were encouraged to offer alternative methods of enforcement, but none were forthcoming. In addition, no alternatives were provided during the comment period. Accordingly, the justification requirement has been retained.

8. Emphasis on competitive negotiations. Many agencies commented that the requirement to use competitive negotiations when the quality of performance over the minimum acceptable level is considered to be worth a corresponding increase in cost (a) violates the Competition in Contracting Act (CICA) as implemented by FAR Part 6.4, and (b) improperly restricts the authority of the contracting officer to select the most appropriate method of contracting.

OFPP disagrees with the assertion that the Policy Letter conflicts with CICA. FAR 6.4 requires that competitive negotiations be used when any one of four prescribed conditions for the use of sealed bidding has not been met. One of these conditions is that the award will be made solely on the basis of price and other price-related factors. The Policy Letter, when addressing circumstances where quality-related factors are to be used in addition to price, is a clear variation from this condition and, therefore, a call for competitive negotiations.

OFPP also disagrees with the assertion that the Policy Letter improperly restricts contracting officers. A major contributor to the problems which led to the development of this Policy Letter was the tendency by several agencies to use sealed bidding for requirements where the quality of performance over the minimum acceptable level was desirable. The Policy Letter is directed at improving agency understanding and compliance with the conditions contained in FAR 6.4. It is not intended to restrict the discretion of agencies to make determinations regarding these conditions.

9. Evaluation factors. Several private sector commenters recommended that the Policy Letter prescribe evaluation criteria to be used in the acquisition of professional and technical services. Specifically mentioned were "cost realism" and, in one case, "past performance". These commenters specifically recommended that "cost realism" be made a mandatory evaluation factor for professional and technical services.

OFPP is opposed to mandating specific evaluation factors. A primary objective of the Policy Letter is to move agencies away from the tendency to overly standardize their service contracting methods to the point where their ability to select the best contractors becomes impaired. To prescribe a given set of evaluation factors for such a wide range of services would overly restrict agency discretion, and would contribute to the problem of over-standardization.

The Policy Letter does require consideration of quality-related evaluation criteria for the acquisition of virtually all professional and technical services. "Cost realism" and "past performance" are two such criteria. "Cost realism" becomes an especially important consideration when evaluating proposals that include uncompensated overtime for employees not covered by the Fair Labor Standards Act or other controlling statutes. This point was acknowledged in the FY 1991 Defense Authorization Act and by the Deputy Under Secretary of Defense

for Acquisition in a memorandum to all military departments and defense agencies. In view of the number of comments received and the significance of the actions taken regarding Department of Defense acquisitions. The Policy Letter has been revised to and out "cost realism" and "past performance" as examples of quality-related factors and to emphasize their importance to the acquisition of professional and technical services.

10. Evaluation process. One private sector commenter recommended that Subparagraph 5(c) Selection procedures require agencies to apply the evaluation factors contained in the solicitations in order to ensure accuracy and equity in proposal evaluation and to avoid technical leveling. OFPP agrees with this comment and has revised Subparagraph 5(c) of the Policy Letter accordingly.

11. Draft solicitations. A few private sector commenters recommended that draft solicitation documents be issued for highly technical or complex services to refine the scope of the proposed efforts and to support market research. OFPP agrees that the issuance of draft solicitations in certain circumstances is desirable, and has revised Subparagraph 5(a) Statement of Work accordingly.

12. Opportunities for oral discussions and proposal revisions. Several agencies commented that the requirement to limit the number of opportunities for oral discussions and resulting proposal revisions could be misinterpreted as discouraging such discussions. They further stated that technical leveling and technical transfusion stem from the content, rather than the number, of the discussions.

OFPP does not wish to suppress oral discussions of proposals. We believe that such discussions are a vital and necessary aspect of competitive negotiations, especially for technical, complex, or unique services. We also agree with the statement that the content of the discussions is the cause of technical leveling and technical transfusion. It is for these reasons the Policy Letter has avoided prescribing the number of opportunities for discussions and proposal revisions. However, an increase in the number of discussions correspondingly increases the opportunities for improper conveyance of information, and so agencies have been requested to limit these opportunities to the minimum number considered necessary. This problem has been already recognized by the Department of Defense, which has instituted controls over second or subsequent requests for best and final offers.

13. Award fee contracting. Several commenters inquired into the Policy Letter's intent toward award fee contracting. The Policy Letter requires the use of incentive provisions where practicable. Award fee is one type of incentive contracting described in FAR 16.4. Accordingly, agencies may use award fee contracts when they consider this method to be appropriate.

14. Termination schedules. One agency questioned whether the Policy Letter's use of the term "termination schedules" when addressing multiyear contracting conflicts with the FAR 17.1 term of "cancellation ceilings". We have eliminated the reference to avoid creating confusion.

15. Implementation timetables. Some agencies commented that (a) the timetable to revise the FAR to implement the Policy Letter is too short, and/or (b) requiring agencies to implement the Policy Letter prior to revision of the FAR may promote a proliferation of unnecessary or misdirected agency level guidance.

OFPP believes the purpose of the Policy Letter is sufficiently important to warrant its implementation as quickly as possible. Additionally, the Defense Acquisition Regulatory Council has been working on revising FAR Part 37. Thus, while the FAR revision timetable may be tight, we do not believe it is unreasonable. However, we acknowledge that premature agency implementation may result in confusion and duplicative effort. Insofar as the deadline for the FAR revision can be maintained, agencies may determine that formal implementation would be best served by waiting until after the FAR is revised. Accordingly, we have revised the Policy Letter to encourage, rather than require, immediate implementation by agencies.

DATES: The Policy Letter is effective 30 days from the date of issuance. It directs that Government-wide regulations be promulgated to implement the policies contained therein in the first Federal Acquisition Circular issued after 120 days after the Policy Letter's effective date.

FOR FURTHER INFORMATION CONTACT: Stanley Kaufman, Deputy Associate Administrator, Office of Federal Procurement Policy, 725 17th Street, NW, Washington, DC 20503. Telephone (202) 395-6803

Allan V. Burman  
Administrator

Dated: April, 9, 1991